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DEPT. OF TRANSPORTATION
DOCKET SECTION

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BEFORE THE
DEPARTMENT OF TRANSPORTATION
WASHINGTON, D.C.

Joint Application of AMERICAN AIRLINES, INC. and EXECUTIVE AIRLINES, INC., FLAGSHIP AIRLINES, INC., SIMMONS AIRLINES INC., and WINGS WEST AIRLINES, INC. (d/b/a AMERICAN EAGLE) and CANADIAN AIRLINES INTERNATIONAL LTD. and ONTARIO EXPRESS LTD. and TIME AIR INC. (d/b/a CANADIAN REGIONAL) and INTER-CANADIAN (1991) INC. under 49 USC 41308 and 41309 for approval of and antitrust immunity for commercial alliance agreement	OST-95-792 -19

COMMENTS OF UNITED AIR LINES, INC.

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DATED: February 6, 1996

BEFORE THE
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COMMENTS OF UNITED AIR LINES, INC.

United Airlines offers the following comments on the application filed jointly by American Airlines, Canadian Airlines International, and their regional affiliates for antitrust immunity for their commercial alliance agreement (the "Joint Application").

1. As United pointed out in a Motion to Defer it filed with the Department on January 25, the Joint Application is premature.[1/] Despite the new liberalized aviation agreement with Canada, the right of U.S. carriers to initiate transborder services to Montreal and Vancouver is restricted until April, 1997 and to Toronto until April, 1998. These three Canadian

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1/ United incorporates herein by reference its Motion, a copy of which is attached hereto.

cities account for approximately 75% of demand in the transborder market, with Toronto alone accounting for nearly 45% of the entire market.[2/] With U.S. carriers' access to 75% of the transborder market still restricted, this is not the time for the Department to be considering the grant of antitrust immunity to a marketing alliance among American, the largest U.S.-flag transborder competitor, Canadian International, and their regional affiliates. Faced with these remaining restrictions on market access, the granting of antitrust immunity to American/Canadian would be the equivalent of granting immunity to an alliance between a U.S. and a U.K. carrier on the basis that, despite the terms of the Bermuda 2 Agreement, access to all points in the United Kingdom has now been opened by the U.K. Government with the exception of London.

In their Joint Application, American and Canadian largely ignore the continuing restrictions on entry into the transborder market for U.S. carriers.[3/] Instead, they argue

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[2/] Based on calendar year 1994 results, as reported by Statistics Canada.

[3/] In a footnote in their Joint Application, American and Canadian claim that "[a]s a practical matter, the restrictions at Vancouver and Montreal are not preventing U.S. carriers from entry, since there are sufficient opportunities to satisfy demand." Joint Application at n. 2. This claim is not well founded. American/Canadian do not address at all the affect of the restrictions at Toronto, which accounts for 45% of the transborder market, and understate the affect of the restrictions on those carriers that were awarded new Montreal and Vancouver routes. For example, as noted infra, the restrictions severely limit the number of daily frequencies United can operate between

(continued...)

that the Department should grant them antitrust immunity as a means "to balance the market power held by Air Canada." There are several problems with this argument.

First, the best way to balance market power is to remove the restrictions on entry into the transborder market. Second, even assuming arguendo that balancing "antitrust immunity" against alleged market power is cognizable in the antitrust analysis of mergers, American/Canadian completely ignore the primary factor for determining whether a transaction, if approved, is likely to lessen substantially competition -- whether other firms have the ability to enter the transborder market within a reasonable time if incumbent firms attempt to charge supra competitive prices. As the Department explained in granting antitrust immunity to the alliance of KLM and Northwest:

> Even if a merger creates a firm with a dominant market share, the merger would not substantially reduce competition if other firms have the ability to enter the market within a reasonable time if the merged firms charge supra competitive prices. Despite the dominant position of KLM ..., we see no barriers to entry by other carriers in that market.... Because of the Open Skies accord, any U.S. carrier may serve the Netherlands from any point in the United States. As a result, other carriers have the opportunity to enter the U.S.-Netherlands market and to increase their service if the applicants try

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[3/](...continued)
Vancouver and its hubs at Denver, Los Angeles and San Francisco; other carriers face similar restrictions trying to serve Vancouver and Montreal from their domestic hubs.

> to raise prices above competitive limits (or lower the quality of service below competitive levels).

Order 92-11-27 at 15-16.

As the Department's order makes clear, the critical issue in the antitrust analysis of airline alliances is entry conditions in the market and the existence of a sufficient number of actual and potential competitors to ensure that marketplace performance will remain competitive. This, of course, is precisely the question that American and Canadian avoid. However, the fact remains that entry into the most significant transborder city pair markets will remain restricted for U.S. carriers for 14 and 26 more months, depending on the Canadian point involved. While these restrictions remain in place, the Department will not have the same assurance that it did when it granted antitrust immunity to KLM and Northwest that other carriers will be able to enter transborder city pairs involving Montreal, Toronto or Vancouver on either a nonstop, one stop, or online connecting basis "within a reasonable time if ... [American/Canadian] charge supra competitive prices." Order 92-11-27 at 15. Without this assurance, the Department should not proceed at this time with the consideration of the Joint Application.

Furthermore, the Joint Applicants' claim that they should be granted antitrust immunity because Air Canada "dominates" the transborder market is based on faulty economics. According to the Joint Applicants, Air Canada has a 24.8% share of the transborder market, based on frequencies. See Exhibit JA-2. Most courts and commentators believe, however, that a market share in excess of 70% is needed to support an inference of dominance over a market. See, e.g., ABA Antitrust Section, Antitrust Law Developments (3d ed. 1992) at 212-213. With a market share below 25%, Air Canada hardly "dominates" the transborder market in any economically meaningful sense of that word.

Equally important, as the restrictions on U.S. carriers' access to Montreal, Toronto and Vancouver expire, Air Canada's share of transborder frequencies should decline as U.S. carriers add service from their domestic hubs to these Canadian destinations. For example, once the frequency restrictions at Vancouver expire in April of 1997, United plans to add service to Vancouver from its hubs at Denver, Los Angeles and San Francisco; under the transitional limitations of the new U.S.-Canada air transport agreement, United can operate only a single daily roundtrip from Denver and Los Angeles to Vancouver, and two daily roundtrips between San Francisco and Vancouver.[4/] Other U.S.

[4/] Comparable limitations exist on United's ability to serve Montreal and Toronto.

carriers that obtained new access to Canada under the transitional terms of the new bilateral agreement are similarly limited in the number of daily roundtrip frequencies they can operate.[5/] Canadian carriers, on the other hand, face no such limitations, and have been able to add transborder service at will since the new agreement was signed. Thus, there is every reason to believe that U.S.-flag service to Canada will expand after the transitional limitations expire and that Air Canada's relative share of transborder frequencies will decline. With Air Canada's current share of transborder frequencies already below 25% and likely to decline, the claim that American and Canadian need antitrust immunity to be able to compete against a "dominant" Air Canada rings very hollow.

2. A decision by the Department to grant the Joint Applicants antitrust immunity at this time would represent a significant departure from its established policy of not granting immunity in the absence of an open skies agremeent. For that reason, United pointed out in its Motion to Defer that if the Department does not defer action on the application, due process and fundamental fairness dictate that the Department notify other carriers of its intent to proceed and set a procedural schedule for the filing of other applications, which would be considered simultaneously with the Joint Application. Motion at 7-9.

[5/] Northwest, for example, can operate only a single daily roundtrip to Vancouver from its hub at Detroit, and Delta can operate only two nonstops per day between Atlanta and Toronto.

Ensuring that other parties have adequate notice of the Department's policies, and of the procedural timetable it intends to follow in considering the Joint Application, is of more than academic interest. United and Air Canada are also parties to an alliance agreement and have been authorized by the Department to code share on transborder services. See Order 95-10-27. If the Department is prepared to proceed with consideration of the American/Canadian application at this time, despite the continuing limits on U.S. carriers' access to Montreal, Toronto and Vancouver, United and Air Canada may need to apply for antitrust immunity for their alliance, and would move to consolidate their application with that of American and Canadian.

Even though an administrative agency normally has broad control of its own calendar, In re Monroe Communications Corporation, 840 F.2d 942 (D.C. Cir. 1988), the Courts have long recognized the need to hold consolidated proceedings where applications may be mutually exclusive. This principle was developed in Ashbacker Radio Corp. v. FCC, 326 U.S. 327 (1945) and subsequent cases, which have been described as "perhaps the most important series of cases in American administrative law." WLVA, Inc. v. FCC, 459 F.2d 1286, 1302 (D.C. Cir. 1972). In order for the Ashbacker doctrine to be applicable, a party need not show that the granting of one license would preclude granting

of the other,[6/] but only that there is a likelihood that its own application will be substantially affected. Id. at 1303 n. 60. (In order for the Ashbacker principle to be applicable, a claimant need not show complete exclusivity, but only that the grant of another application is likely to affect substantially the outcome of its own application.) See also Delta Air Lines, Inc. v. CAB, 275 F.2d 632 (D.C. Cir. 1959), cert. denied sub nom Eastern Airlines Inc., v. CAB, 326 U.S. 969 (1960).

There is little question that a decision by the Department to grant American/Canadian antitrust immunity will substantially affect the outcome of subsequent applications for immunity for transborder alliances by other U.S. and Canadian carriers. In deciding whether an application for immunity should be granted, the Department applies the same standards used to determine whether a transaction is consistent with the antitrust laws. See Order 92-11-27 at 13. (In determining whether the proposed transaction should be granted antitrust immunity, we will apply the standards of Section 7 of the Clayton Act that are used in examining whether mergers will substantially reduce competition in any relevant market).

[6/] The Administrative Procedure Act defines a "license" to include "the whole or a part of any agency ... approval ... or other form of permission ...." 5 U.S.C. §551(8). A license is generally understood to be a grant by a government authority or agency of a right to engage in conduct that would be improper without such a grant. See Stein, Mitchell, Mezines Administrative Law at ¶ 41.04.

Under the standards of the Clayton Act, market concentration is deemed by the federal antitrust agencies to be a significant measure of the competitiveness of a market. U.S. Department of Justice and the Federal Trade Commission, Horizontal Merger Guidelines, §1.5 (1992). Because mergers always make a market more concentrated, holding all else equal, previous mergers or acquisitions will make market conditions more suspect from an antitrust enforcement perspective for companies that subsequently wish to consolidate. This fact was driven home last year when the FTC vigorously opposed the acquisition of PCS Health Systems, a pharmacy benefit management company ("PBM"), by Eli Lilly, the nation's seventh largest pharmaceutical manufacturer, even though the agency had previously cleared two other acquisitions of PBMs by pharmaceutical companies that were larger than Eli Lilly.

Commenting on the case, Mark Whitener, Deputy Director of the FTC's Bureau of Competition, stated: "As with markets that are undergoing other types of structural changes -- through a series of horizontal acquisitions, for example -- changing market conditions in pharmaceutical and PBM markets can affect the antitrust analysis of a particular transaction. Each must be viewed in the context of the current, and likely future, market structure." Competition and Antitrust Enforcement in the Changing Pharmaceutical Marketplace, Prepared Remarks of Mark D. Whitener, Dec. 13, 1994.

In their capacity as enforcement agencies, the decisions of the FTC and the Department of Justice are not subject to the Ashbacker doctrine. The Department, on the other hand, cannot fairly carry out its administrative responsibilities under the statute if it fails to comply with Ashbacker. A decision to grant antitrust immunity to the American/Canadian alliance will both affect competition in the transborder market and U.S. trade relations with Canada. For the Department to ensure that its decisions are fair and equitable to all parties concerned, it will need to consider simultaneously all applications for antitrust immunity for transborder alliances.

3. In urging the Department to defer action on the Joint Application, United is not questioning the fact that the public benefits from code sharing and inter-carrier alliance agreements, and that the public can also benefit from the grant of antitrust immunity for such alliances where there is in place an aviation agreement providing for open entry. U.S. international aviation policy firmly endorses code-sharing and cooperative marketing alliances as important means for carriers to address the preference of passengers and shippers for an integrated on-line transportation product. As noted in the Department's International Policy Statement, such alliances facilitate carriers' ability to provide consumers "on-line service from beginning to end through coordinated scheduling, baggage- and cargo-handling, and other elements of single-carrier service."

International Policy Statement at 5. The Department's Policy Statement also recognizes that:

> Code sharing and other cooperative marketing arrangements can provide a cost-efficient way for carriers to enter new markets, expand their systems and obtain additional flow traffic to support their other operations by using existing facilities and scheduled operations. Because these cooperative arrangements can give the airline partners new or additional access to more markets, the partners will gain traffic, some stimulated by the new service, and some diverted from incumbents. In this way, cooperative arrangements can enhance the competitive positions of both partners in such a relationship.

Id. at 4.

The Department has also found that antitrust immunity can both improve carriers' ability to maximize the efficiency gains available from operating a global hub-and-spoke route network, and enhance the attractiveness to foreign governments of signing an open skies agreement with the United States. For that reason, in commenting upon the joint application filed by Delta and three European carriers for antitrust immunity in docket 95-618, United encouraged the Department to grant immunity in circumstances where the overall net effect of doing so would be to improve the alliance partners' ability to respond to consumer demand and to increase competition. Answer of United Air Lines, Inc. at 10.

While the transborder market remains subject to significant entry limitations, the Department has no assurance that a decision to grant antitrust immunity to the American/Canadian alliance would be pro-consumer and pro-competitive. For that reason, the Department should defer action on the Joint Application as United requested in its pending Motion to Defer.

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DATED: February 6, 1996

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CERTIFICATE OF SERVICE

I hereby certify that I have this date served a copy of the foregoing Comments of United Air Lines, Inc. to the persons on the attached Service List by causing a copy to be sent via first class mail, postage prepaid.

Kathryn D. North

DATED: February 6, 1996

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MOTION OF UNITED AIR LINES, INC. TO DEFER APPLICATION

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BEFORE THE
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MOTION OF UNITED AIR LINES, INC. TO DEFER APPLICATION

United Airlines hereby requests that the Department defer action on the application filed jointly by American Airlines, Canadian Airlines International, and their regional affiliates for antitrust immunity for their commercial alliance agreement (the "Joint Application").

The Joint Application has been filed prematurely. Even though the U.S. and Canada have concluded a liberalized aviation agreement, entry into the transborder market for U.S. carriers will continue to be subject to significant restrictions until April 1998. Because the expiration of these restrictions is far from imminent, the Department should not be considering at this time the grant of antitrust immunity to a marketing alliance among American, the largest U.S.-flag transborder competitor,

Canadian International, and their regional affiliates. To do so would represent a significant departure from established DOT policy. In the event the Department does not defer action on the Joint Application, due process and fundamental fairness dictate that the Department notify other carriers of its intent to proceed and set a procedural schedule for the filing of other applications for antitrust immunity for transborder alliances, which would then be considered simultaneously with the Joint Application.

In further support of this Motion, United submits the following:

I. THE AMERICAN/CANADIAN JOINT APPLICATION IS PREMATURE.

U.S. international aviation policy firmly endorses code-sharing and cooperative marketing alliances as important means for carriers to address the preference of passengers and shippers for an integrated on-line transportation product. As noted in the Department's International Policy Statement, such alliances facilitate carriers' ability to provide consumers "on-line service from beginning to end through coordinated scheduling, baggage-and cargo-handling, and other elements of single-carrier service." International Policy Statement at 5. The Department's Policy Statement also recognizes that:

> Code sharing and other cooperative marketing arrangements can provide a cost-efficient way

> for carriers to enter new markets, expand their systems and obtain additional flow traffic to support their other operations by using existing facilities and scheduled operations. Because these cooperative arrangements can give the airline partners new or additional access to more markets, the partners will gain traffic, some stimulated by the new service, and some diverted from incumbents. In this way, cooperative arrangements can enhance the competitive positions of both partners in such a relationship.

Id. at 4.

United is not opposed to the Department's granting antitrust immunity to carriers participating in code sharing and marketing alliances. On the contrary, in its answer to the application for antitrust immunity filed jointly by Delta Air Lines, Austrian Airlines, Swissair, and Sabena, United pointed out that such immunity can both improve carriers' ability to maximize the efficiency gains available from operating a global hub-and-spoke route network, and enhance the attractiveness to foreign governments of signing an open skies agreement with the United States. Answer of United Air Lines, Inc., docket OST 95-618, at 5-6. For that reason, United encouraged the Department to grant immunity in circumstances where the overall net effect of doing so would be to improve the alliance partners' ability to respond to consumer demand and to increase competition. Id. at 10.

Up to now, the Department's policy has been to grant antitrust immunity for alliances only in circumstances where

there is open market access. Absent such access, a decision to grant immunity to an alliance such as that between American and Canadian may not prove to be pro-consumer and pro-competitive. On the contrary, in the short term, the grant of antitrust immunity would allow American and Canadian to enhance their competitive position in the transborder market while other U.S.-flag carriers are limited in their ability to mount a competitive response because of the limitations imposed by the transitional agreement.

Because of these limitations, United, for example, is unable to operate more than two roundtrip frequencies per day between its hub at San Francisco and Vancouver and only a single daily frequency between Vancouver and its hubs at Denver and Los Angeles. United holds no authority at all to operate nonstop between Vancouver and its hub at Washington's Dulles Airport, nor between Denver and Toronto; its U.S.-Canada authority is also limited at its international gateways at Dulles and Miami International Airports. Other U.S.-flag incumbents face similar restrictions on their ability to introduce new transborder services and to expand their existing services at Montreal, Toronto, and Vancouver, the three principal traffic generating points in Canada.

The old U.S.-Canada bilateral was a highly restrictive agreement that prevented U.S. and Canadian carriers from

integrating transborder services into their domestic hub and spoke networks. This limitation has now been ameliorated to some extent by the new agreement. The reality, however, is that because of the substantial restrictions that continue to exist at Montreal, Toronto and Vancouver, transborder services continue to reflect more the pattern of historic route awards under the old, highly restrictive bilateral, than networks developed in a free market to respond to consumer demand. In this sense, the transborder market is significantly different from the transatlantic market, where the only two other alliances that have sought antitrust immunity are centered. For a number of reasons, most carriers' services between the U.S. and Europe now largely reflect the hub and spoke network structure of the U.S. domestic market rather than the old pre-deregulation pattern of route awards.

Indicative of the limitations that still exist on the provision of transborder service are the limitations on nonstop service by USAir and United, respectively, between Pittsburgh and Toronto and San Francisco and Vancouver, even though they operate hubs at the U.S. end points of these two routes. In a free market, it is unlikely that United and USAir would operate only two roundtrips per day over these routes, although each carrier is limited to that level of service under the transitional terms of the agreement.

The net result is that while antitrust immunity will directly and materially strengthen American's and Canadian's position as transborder competitors, other U.S. carriers will be unable freely to mount competitive responses that meet consumer demand and reflect the inter-play of market forces because of the limitations that still exist under the transitional agreement. Because of these limitations, it would not be consistent with the public interest for the Department to consider the grant of antitrust immunity to American and Canadian at this time.

II. A GRANT OF ANTITRUST IMMUNITY TO AMERICAN AND CANADIAN AT THIS TIME WOULD BE INCONSISTENT WITH ESTABLISHED DOT POLICY AND WOULD UNDERMINE U.S. EFFORTS TO NEGOTIATE LIBERAL AGREEMENTS

The grant of antitrust immunity at this time to American and Canadian would represent a fundamental shift in U.S. policy and would undermine U.S. efforts to negotiate liberal bilateral agreements with this country's major trading partners. Heretofore, the Department has indicated that the availability of antitrust immunity for trans-national marketing alliances is to be used as an inducement for foreign governments to enter into liberal, pro-competitive bilateral agreements with the United States. Thus, in explaining its decision to grant immunity to the alliance between KLM and Northwest, the Department emphasized that "our approval of and grant of antitrust immunity to the Agreement ... [should] encourage other European countries to

agree to liberalize their aviation ... [relations with the United States.]" Order 92-11-27 at 13-14.

This is a sound policy. The availability of antitrust immunity is a strong inducement for this country's major trading partners to open their international aviation markets to entry by U.S. carriers. In an industry in which cross-national mergers and joint-ventures are limited by foreign-ownership laws and cabotage restrictions, antitrust immunity can play a key role in facilitating carriers' ability to utilize alliances to achieve the full efficiency gains possible from hub-and-spoke operating systems.

Because alliances with immunity should be able to achieve greater cost efficiencies than alliances without immunity, foreign governments interested in securing the maximum benefits for their flag carriers from participation in code sharing alliances with U.S. airlines have a strong incentive to agree to liberalize access to their markets to whatever degree the Department requires for the grant of immunity. If open entry is the Department's condition, as it has been up to now, foreign governments have a strong incentive to agree to open entry. However, if immunity can be obtained while transitional limitations on entry remain in place, foreign governments will have a strong incentive to insist upon such limitations to protect their carriers from competition while still demanding

immunity for alliances between their national airlines and U.S. carriers. Thus, a decision to proceed with consideration of the Joint Application while the transitional limitations of the U.S.-Canada bilateral remain in place would both reverse current U.S. policy, and send a message to other foreign governments that something less than open entry may be sufficient to secure antitrust immunity for marketing alliances between their national airlines and U.S airlines. Sending such a message can only exacerbate the difficulties the Department faces in securing more liberalized agreements with our major trading partners.

III. IF THE DEPARTMENT DOES NOT DISMISS THE JOINT APPLICATION, IT SHOULD SET A PROCEDURAL TIMETABLE FOR THE FILING OF OTHER APPLICATIONS

A decision to proceed with substantive consideration of the Joint Application at this time would represent a fundamental shift in Department policy. If, notwithstanding the obvious policy and competitive disadvantages that will result from such a shift, the Department does not formally defer action on the Joint Application, due process and fundamental fairness dictate that the Department provide other incumbents in the transborder market notice of its change in policy and an opportunity to file their own applications for antitrust immunity, which would then be considered simultaneously with the Joint Application.

WHEREFORE, for the reasons set forth, United Air Lines, Inc. hereby requests that the Department either (i) defer action

on the Joint Application filed by American Airlines, Canadian Air Lines and their regional affiliates for antitrust immunity, or (ii) issue an order establishing a procedural schedule for other interested carriers to file applications for antitrust immunity, which would be considered simultaneously.

Respectfully submitted,

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